No. 89-1794

In the Supreme Court of the United States

OCTOBER TERM, 1990

GERALD L. SCHULMAN, PETITIONER

v.

UNITED STATES OF AMERICA

ON PETITION FOR A WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE NINTH CIRCUIT

BRIEF FOR THE UNITED STATES IN OPPOSITION

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QUESTIONS PRESENTED

1. Whether the court of appeals, in reversing the district court's order granting petitioner's pretrial motion to dismiss the indictment, directed the district court to return a guilty verdict against petitioner.

2. Whether comments by the trial judge, sitting as the trier of fact, constitute a basis for overturning petitioner's conviction.

3. Whether the court of appeals correctly determined that certain alleged transactions were clearly prohibited by law at the time they were undertaken.

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OPINIONS BELOW

The opinion of the court of appeals reversing in part the district court's order dismissing the indictment (Pet. App. E1-E13) is reported at 817 F.2d 1355. The opinion of the court of appeals affirming petitioner's conviction (Pet. App. A1-A13) is unpublished, but the decision is noted at 889 F.2d 1097 (Table).

JURISDICTION

The judgment of the court of appeals was entered on November 15, 1989. A petition for rehearing was denied on February 14, 1990. Pet. App. B1-B2. The petition for a writ of certiorari was filed on May 15, 1990. The jurisdiction of this Court is invoked under 28 U.S.C. 1254(1).

STATEMENT

1. In May 1986, petitioner was indicted in the Central District of California. He was charged with one count of conspiracy to defraud the United States by "impeding, impairing, obstructing, and defeating the lawful functions of the Internal Revenue Service," in violation of 18 U.S.C. 371; 18 counts of aiding and assisting in the preparation of false partnership returns and individual income tax returns, in violation of 26 U.S.C. 7206(2); one count of filing a false income tax return, in violation of 26 U.S.C. 7206(1); and five counts of making false declarations in a sworn statement to the Internal Revenue Service, in violation of 18 U.S.C. 1623. Pet. App. E5; Gov't C.A. Br. 2-3.

Prior to trial, the district court dismissed the conspiracy and tax fraud charges. Relying primarily on *United States* v. *Dahlstrom*, 713 F.2d 1423 (9th Cir. 1983), cert. denied, 466 U.S. 980 (1984), the court held that, as a matter of law, the government would not be able to establish that petitioner acted with the requisite intent to violate the law because it could not demonstrate that the tax shelter scheme at issue was clearly illegal during the prosecution years. The court also dismissed several of the false declarations counts on the ground that the statements at issue were ambiguous. Pet. App. D1-D11.

The court of appeals affirmed in part and reversed in part. With respect to the dismissal of the false declarations counts, the court of appeals affirmed. With respect to the conspiracy and tax fraud counts, however, the court reversed. Pet. App. E1-E13 (*Schulman I*). The court concluded that, "assuming the truth of the allegations in the indictment, the defendant was engaged in promoting a tax scheme, the illegality of which he had fair notice." *Id.* at E12-E13. Since petitioner's intent to violate the law could not be ruled out as a matter of law, the court held, dismissal of the conspiracy and tax fraud charges was improper. *Id.* at E10.

On remand, following a three-day bench trial, petitioner was convicted on the conspiracy and tax fraud counts. Pet. App. C1-C3.[1] The imposition of sentence was suspended and petitioner was placed on five years' probation and ordered to perform 1000 hours of community service. As special conditions of probation, he was ordered to pay all taxes, including interest and penalties, and to pay the costs of prosecution. *Id.* at C2.

2. The evidence at trial established that, during 1978 and 1979, petitioner organized and promoted approximately 87 partnerships, for which petitioner was the general partner. While the ostensible purpose of the partnerships was to acquire post office and public utility buildings for lease to the government, petitioner represented to potential investors that they would obtain a 100% write-off of initial contributions to the partnerships, along with an interest in rental payments from lessees of the purchased properties. Pet. App. A2; Gov't C.A. Br. 6.

The promised tax objective was to be realized using a series of off-shore financing and loan transactions between the partnerships and two foreign corporations: Hexagram, a Netherlands Antilles corporation, and Parallax, a Panamanian corporation. Hexagram and Parallax had bank accounts at Banco de Iberoamerica (Iberoamerica) in Panama, and at Barclays Bank in the Netherlands. Although the government stipulated that petitioner had no direct or indirect ownership interest in Hexagram or Parallax, the government introduced evidence that petitioner actually controlled those corporations. Pet. App. A2-A3; Gov't C.A. Br. 7, 11-12.

The following circular transaction was executed for each partnership: (1) Iberoamerica credited the account of

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[1] Petitioner was acquitted on the two remaining false declarations counts. Gov't C.A. Br. 5.

Hexagram with approximately $3 million, in return for a promissory note at 9.75% interest; (2) Hexagram signed over a check for the $3 million to one of petitioner's partnerships in return for a promissory note at 10% interest; (3) petitioner's partnership transferred the $3 million to Parallax at no interest and on a short-term basis, and, in return, Parallax agreed to locate suitable property for the partnership and to obtain favorable long-term financing for the purchase of the real estate; and (4) Parallax deposited the $3 million obtained from petitioner's partnership in the Parallax account at Iberoamerica, with instructions to apply the proceeds to the purchase of Hexagram's promissory note to Iberoamerica. Pet. App. A2-A3; Gov't C.A. Br. 7-8.

Thus, the circle of transactions was completed without any of the parties, including Iberoamerica, making a cash outlay—the transaction was a total wash. The paper generated by these transactions indicated total debits and credits to the accounts of Hexagram, petitioner's partnerships, and Parallax of $252 million. Pet. App. A2-A3.

One year later, through a series of similar transactions with Barclays Bank, the debt of all the partnerships was removed from their books. In addition, a series of debits and credits were posted to the various accounts which purported to represent the payment of interest by the partnerships. Pet. App. A3-A4; Gov't C.A. Br. 9-10.

Petitioner signed the partnership information returns for each of the partnerships in his capacity as general partner and as the return preparer. Those returns claimed more than $25 million as interest deductions, and petitioner provided each partner with a Schedule K showing the partner's share of the interest deductions. On petitioner's advice and with his assistance, the investors deducted these interest expenses from gross income on their individual federal income tax returns. Gov't C.A. Br. 11.

3. On appeal, petitioner contended that there was insufficient evidence to prove that he acted with specific intent to violate the law. He also pointed to remarks made by the trial judge during the course of the proceedings (see Pet. 9-13) in an attempt to impugn the validity of the verdict. The court of appeals affirmed. Pet. App. A1-A13 (*Schulman II*). The court rejected petitioner's argument that his good faith reliance on the advice of counsel and the alleged validity of a similar tax plan should defeat a finding that he specifically intended to violate the law. *Id.* at A7-A8. In addition, the court held that petitioner's background as an attorney and an accountant was properly considered in determining whether he possessed the requisite intent to violate the law. *Id.* at A8-A9. Finally, the court concluded that the statements made by the trial judge simply indicated that this was a close case and that there was circumstantial evidence that could have supported an acquittal. Contrary to petitioner's contention, the court of appeals held, the trial judge's statements "do not establish that the judge failed to make independent findings of fact, or that she did not conclude that [petitioner] was guilty beyond a reasonable doubt." *Id.* at A9.

ARGUMENT

1. Petitioner contends (Pet. 16-21) that the *Schulman I* court, in reversing the district court's order dismissing the indictment, usurped the district court's role as trier of fact by dictating the outcome of the trial. There is no merit to this claim.

In its opinion reversing the dismissal order, the *Schulman I* court ruled that the allegations contained in the indictment were sufficient to withstand dismissal. Citing *Knetsch* v. *United States*, 364 U.S. 361 (1960), the court noted that "for an interest payment to be deductible, the interest must

be paid on genuine indebtedness" and "[w]hen there is no genuine indebtedness underlying the interest payment, the transaction is a sham." Pet. App. E8. The court held that "[t]he indictment sufficiently alleges a lack of substance behind the check cycle to sustain the charges against a motion to dismiss." *Id.* at E9. Thus, the *Schulman I* court rejected the district court's determination that the facts contained in the indictment, if proved at trial, were insufficient as a matter of law to constitute the basis for a finding that petitioner had the requisite intent to violate the law.

The *Schulman I* court did not, as petitioner asserts, direct the district court to return a guilty verdict. It simply found that, assuming the facts contained in the indictment to be true, the transactions described therein were clearly illegal. In so holding, the court rejected the lower court's conclusion that, as a matter of law, petitioner lacked the requisite intent to violate the law because he was not given fair notice of the requirements of the law. The *Schulman I* court clearly did not make a factual finding that the allegations contained in the indictment were true.[2] Nor did it find that petitioner possessed the requisite intent to violate the tax laws.[3] To the contrary, the court of appeals clarified the legal question and left the district court free to determine whether

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[2] See Pet. App. E9 ("The indictment *sufficiently alleges* a lack of substance behind the check cycle to sustain the charges against a motion to dismiss.") (emphasis added); *ibid.* ("[T]he *allegations* in this case are sufficient to withstand dismissal.") (emphasis added); *id.* at E10 ("*Assuming* that [the government's] contention is true there is no risk of any sort in the underlying financing transactions * * *.") (emphasis added).

[3] See Pet. App. E10 ("[D]ismissal of the indictment was improper since an intent to violate the law *cannot be ruled out as a matter of law.*") (emphasis added); *id.* at E10 n.1 ("The government is correct in saying [petitioner's] knowledge and understanding of the implications of the Margolis trial is a factual question for the jury.").

petitioner willfully violated the law. The court of appeals therefore did not direct a verdict against petitioner.

2. Petitioner also contends (Pet. 21-25) that the district judge improperly convicted him despite the judge's expressed doubts as to his guilt. As the court of appeals correctly found, the comments by the trial judge on which petitioner bases his claim do not establish that the district court failed either to make independent findings of fact or to conclude that petitioner was guilty beyond a reasonable doubt. Rather, the statements simply indicate that the trial judge believed the case was close and that there was some circumstantial evidence which could have supported a not guilty verdict. Pet. App. A9.

The district court's remarks, read in the context of the entire record, do not constitute a basis for overturning petitioner's conviction. In holding that petitioner's post-verdict motion for acquittal should be denied, the trial judge explicitly stated that she had painstakingly weighed the evidence and concluded that the government had carried its burden of proving petitioner guilty beyond a reasonable doubt:

> It is really a bit by bit by bit analysis of the evidence and the inferences that can be drawn from it and I do not say that this period of time has not presented to me in three or four different ways some doubt about whether [petitioner] was guilty or not. I did that the first time. I did that the second time I looked at the evidence and the third time. *However, I do believe that the government carried the burden beyond a reasonable doubt*. That doesn't mean there isn't any, so putting aside the procedural objections that were given to or put by the government to what is a motion for a new trial or a motion for reconsideration, putting those aside, and *looking at it afresh which I did, I find him guilty*.

Aug. 1, 1988 Tr. 4 (emphasis added). These remarks reflect an appropriate understanding of the judge's role as the trier

of fact.[4] There is nothing in the record that suggests the judge did not understand the basic elements of the crimes charged. Nor is there any comment that demonstrates that she failed to apply the law properly to this case. To the contrary, the judge's remarks bespeak a close scrutiny of the record, followed by the conclusion that the government carried its burden of proving its case beyond a reasonable doubt.

As the court of appeals held in rejecting petitioner's challenge to the sufficiency of the evidence, moreover, this ultimate conclusion was entirely reasonable. The district court recognized that the principal issue in dispute was petitioner's intent.[5] Given the nature and extent of petitioner's involvement in the management and operation of the clearly illegal scheme, coupled with his background as an accountant and an attorney, there was ample proof that petitioner possessed the requisite intent. Moreover, the government convincingly rebutted petitioner's claim that he did not knowingly participate in illegal conduct because he had relied in good faith on advice of counsel. Pet. App. A7-A9.

In these circumstances, where there is no affirmative indication that the trial judge did not understand the elements of the crimes or her duty as a fact finder to determine whether the evidence proved each element beyond a reasonable doubt, the reviewing court should not attempt to scrutinize the reasoning process used by the factfinder.

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[4] Petitioner quotes post-trial comments from four proceedings: (1) on February 12, 1988, when the judge found him guilty; (2) on March 28, 1988, when the judge heard arguments on his post-verdict motion for acquittal; (3) on August 1, 1988, when she denied his post-verdict motion for acquittal; and (4) on November 15, 1988, when the district court formally sentenced petitioner. Pet. 9-13.

[5] See, *e.g.*, Aug. 1, 1988 Tr. 3 (The court: "The evidence that came on in front of the court at the trial all went to the state of mind of [petitioner].").

Harris v. *Rivera*, 454 U.S. 339, 348 n.20 (1981) (quoting *Jackson* v. *Virginia*, 443 U.S. 307, 319-320 n.13 (1979)).

3. Finally, petitioner contends (Pet. 25-30) that the *Schulman I* decision regarding the illegality of the transactions alleged in the indictment conflicts with *United States* v. *Mallas*, 762 F.2d 361 (4th Cir. 1985), and *United States* v. *Critzer*, 498 F.2d 1160 (4th Cir. 1974). But the absence of any uncertainty in the law as applied to petitioner's circular financing scheme distinguishes this case from *Mallas* and *Critzer*. In *Mallas*, the court found that the question of the validity of a particular tax shelter was sufficiently unsettled that the defendants lacked the requisite criminal intent to be convicted of tax evasion. 762 F.2d at 363-364. In *Critzer*, the defendant, an Eastern Cherokee Indian, had been advised by the Bureau of Indian Affairs that her income in question was not taxable. Indeed, the Bureau continued to maintain that position at the time of trial and on appeal. The court of appeals held that "[a]s a matter of law, defendant cannot be guilty of willfully evading and defeating income taxes on income, the taxability of which is so uncertain that even co-ordinate branches of the United States Government plausibly reach directly opposing conclusions." 498 F.2d at 1162.

These decisions are inapposite here because, in this case, existing legal authority made it clear that petitioner's tax shelter scheme was invalid. Petitioner's indictment charged that the central feature of the scheme was nothing more than a sham transaction – the creation of records to make it appear as though interest had been paid on genuine indebtedness when, in fact, there was no genuine indebtedness and no interest paid. Pet. App. E9-E10. Long before the period that is the subject of this prosecution, this Court had repeatedly held that sham transactions are illegal. In *Commissioner* v. *Court Holding Co.*, 324 U.S. 331, 334 (1945), the Court established the principle that the true nature of

a transaction may not "be disguised by mere formalisms." In *Knetsch* v. *United States*, 364 U.S. 361 (1960), the Court clearly held that in order to be deductible, interest must be paid on genuine indebtedness; otherwise the transaction is a sham. Thus, the crucial aspects of the charged scheme were governed by well-established principles of law which left no room for doubt at the time of the offense that petitioner's tax shelter scheme was patently illegal.[6]

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[6] Petitioner contends (Pet. 25-27) that the Ninth Circuit, in *Schulman I*, effectively abandoned its prior holding in *United States* v. *Dahlstrom*, 713 F.2d 1423 (1983), cert. denied, 466 U.S. 980 (1984). In *Dahlstrom*, the court held that the shelter scheme there was not clearly illegal at the time the defendants entered into it and, hence, the requisite intent was not shown. The court further noted that the First Amendment protected the defendants' advocacy of the shelter scheme unless it was directed at producing imminent lawless action. 713 F.2d at 1428. As set forth above, however, the financial transactions at issue in this case were blatant shams. And, as the *Schulman I* court properly held, petitioner plainly has no entitlement to First Amendment protection because his conduct went well beyond mere advocacy and amounted to direct participation in the unlawful conduct. See also *United States* v. *Little*, 753 F.2d 1420, 1433-1434 (9th Cir. 1984). To the extent that petitioner raises an intra-circuit conflict, moreover, such a claim does not provide a basis for this Court's review. See *Wisniewski* v. *United States*, 353 U.S. 901, 902 (1957).

CONCLUSION

The petition for a writ of certiorari should be denied.
Respectfully submitted.

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